Exhibit 14

FINISAR CORP

FORM 10-Q
(Quarterly Report)

Filed 12/04/07 for the Period Ending 07/29/07

Address	1389 MOFFETT PARK DR SUNNYVALE, CA 94089
Telephone	4085481000
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Symbol	FNSR
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Industry	Communications Equipment
Sector	Technology
Fiscal Year	04/30

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

☑ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended July 29, 2007

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 000-27999

Finisar Corporation

(Exact name of Registrant as specified in its charter)

Delaware *(State or other jurisdiction of incorporation or organization)*	**94-3038428** *(I.R.S. Employer Identification No.)*
1389 Moffett Park Drive **Sunnyvale, California** *(Address of principal executive offices)*	**94089** *(Zip Code)*

Registrant's telephone number, including area code:

408-548-1000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☑

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

At November 30, 2007, there were 308,634,829 shares of the registrant's common stock, $.001 par value, issued and outstanding.

INDEX TO QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended July 29, 2007

PART I — FINANCIAL INFORMATION

Item 1. *Financial Statements*

FINISAR CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

	July 29, 2007	April 30, 2007
	(in thousands, except per share data)	
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 52,090	$ 56,106
Short-term investments	59,910	56,511
Restricted investments, short-term	625	625
Accounts receivable, net of allowance for doubtful accounts of $1,282 and $1,607 at July 29, 2007 and April 30, 2007	58,434	55,969
Accounts receivable, other	4,724	7,752
Inventories	77,351	77,670
Prepaid expenses	4,352	4,553
Total current assets	257,486	259,186
Long-term investments	17,285	19,855
Property, plant and improvements, net	84,325	84,071
Purchased technology, net	16,622	18,351
Other purchased intangible assets, net	5,157	5,647
Goodwill, net	128,949	128,949
Minority investments	11,250	11,250
Other assets	19,832	19,363
Total assets	$ 540,906	$ 546,672
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 32,825	$ 40,187
Accrued compensation	12,977	10,550
Other accrued liabilities	15,287	12,590
Deferred revenue	5,864	5,473
Current portion of other long-term liabilities	2,299	2,255
Convertible notes	66,950	66,950
Non-cancelable purchase obligations	2,676	2,798
Total current liabilities	138,878	140,803
Long-term liabilities:		
Convertible notes, net of beneficial conversion feature of $5,988 and $7,184 at July 29, 2007 and April 30, 2007	194,262	193,066
Other long-term liabilities	20,346	21,042
Deferred income taxes	6,634	6,090
Total long-term liabilities	221,242	220,198
Commitments and contingent liabilities		
Stockholders' equity:		
Preferred stock, $0.001 par value, 5,000,000 shares authorized, no shares issued and outstanding at July 29, 2007 and April 30, 2007		
Common stock, $0.001 par value, 750,000,000 shares authorized, 308,634,829 shares issued and outstanding at July 29, 2007 and 308,632,366 shares issued and outstanding at April 30, 2007	309	309
Additional paid-in capital	1,532,068	1,529,322
Accumulated other comprehensive income	10,852	11,162
Accumulated deficit	(1,362,443)	(1,355,122)
Total stockholders' equity	180,786	185,671
Total liabilities and stockholders' equity	$ 540,906	$ 546,672

See accompanying notes

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FINISAR CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended July 29, 2007	Three Months Ended July 30, 2006
	(Unaudited, in thousands, except share and per share data)	
Revenues:		
Optical subsystems and components	$ 96,360	$ 96,043
Network test and monitoring systems	9,375	10,200
Total revenues	105,735	106,243
Cost of revenues	71,703	70,721
Amortization of acquired developed technology	1,729	1,519
Gross profit	32,303	34,003
Operating expenses:		
Research and development	17,502	14,395
Sales and marketing	10,056	8,834
General and administrative	7,991	7,514
Amortization of purchased intangibles	490	299
Total operating expenses	36,039	31,042
Income (loss) from operations	(3,736)	2,961
Interest income	1,415	1,255
Interest expense	(4,246)	(3,921)
Other expense	(133)	(370)
Loss before income taxes and cumulative effect of change in accounting principle	(6,700)	(75)
Provision for income taxes	621	631
Loss before cumulative effect of change in accounting principle	(7,321)	(706)
Cumulative effect of change in accounting principle	—	(1,213)
Net income (loss)	$ (7,321)	$ 507
Net income (loss) per share — basic:		
Before effect of adoption of change in accounting principle	$ (0.02)	$ 0.00
Cumulative effect of change in accounting principle	$ —	$ 0.00
Net income (loss)	$ (0.02)	$ 0.00
Net income (loss) per share — diluted:		
Before effect of adoption of change in accounting principle	$ (0.02)	$ 0.00
Cumulative effect of change in accounting principle	$ —	$ 0.00
Net income (loss)	$ (0.02)	$ 0.00
Shares used in computing net loss per share — basic	308,634	306,499
Shares used in computing net loss per share — diluted	308,634	323,845

See accompanying notes.

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FINISAR CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	July 29, 2007	July 30, 2006
	(Unaudited, in thousands)	
Operating activities		
Net income (loss)	$ (7,321)	$ 507
Adjustments to reconcile net (loss) to net cash provided by operating activities:		
Depreciation and amortization	6,815	6,708
Stock-based compensation expense	2,759	3,447
Amortization of beneficial conversion feature of convertible notes	1,196	1,148
Amortization of purchased intangibles	490	299
Amortization of acquired developed technology	1,729	1,519
Amortization of discount on restricted securities	(11)	(32)
Gain on sale or retirement of equipment	52	39
Share of losses of equity investee	—	237
(Gain) loss on sale of equity investment	(117)	—
Changes in operating assets and liabilities:		
Accounts receivable	(2,465)	(8,184)
Inventories	(101)	694
Other assets	1,913	(1,171)
Deferred income taxes	544	544
Accounts payable	(7,362)	1,310
Accrued compensation	2,427	798
Other accrued liabilities	2,594	276
Deferred revenue	391	345
Net cash provided by operating activities	3,533	8,484
Investing activities		
Purchases of property, equipment and improvements	(6,010)	(6,117)
Proceeds from sale of property and equipment	39	35
Sale (purchase) of short-term and long-term investments	(1,352)	(3,386)
Proceeds from sale of equity investment	323	—
Net cash used in investing activities	(7,000)	(9,468)
Financing activities		
Repayments of liability related to sale-leaseback of building	(86)	(70)
Repayments of borrowings	(463)	(527)
Proceeds from exercise of stock options and employee stock purchase plan	—	1,692
Net cash provided by (used in) financing activities	(549)	1,095
Net increase (decrease) in cash and cash equivalents	(4,016)	111
Cash and cash equivalents at beginning of period	56,106	63,361
Cash and cash equivalents at end of period	$ 52,090	$ 63,472
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 109	$ 177
Cash paid for taxes	$ 149	$ 48

See accompanying notes.

FINISAR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Description of Business

Finisar Corporation is a leading provider of optical subsystems and components that connect local area networks, or LANs, storage area networks, or SANs, and metropolitan area networks, or MANs. Our optical subsystems consist primarily of transceivers which provide the fundamental optical-electrical interface for connecting the equipment used in building these networks. These products rely on the use of digital semiconductor lasers in conjunction with integrated circuit design and novel packaging technology to provide a cost-effective means for transmitting and receiving digital signals over fiber optic cable using a wide range of network protocols, transmission speeds and physical configurations over distances of 70 meters to 200 kilometers. Our line of optical components consists primarily of packaged lasers and photodetectors used in transceivers, primarily for LAN and SAN applications. Our manufacturing operations are vertically integrated and include internal manufacturing, assembly and test capability. We sell our optical subsystem and component products to manufacturers of storage and networking equipment such as Brocade, Cisco Systems, EMC, Emulex, Hewlett-Packard Company, Huawei and Qlogic.

We also provide network performance test and monitoring systems to original equipment manufacturers for testing and validating equipment designs and, to a lesser degree, to operators of networking and storage data centers for testing, monitoring and troubleshooting the performance of their installed systems. We sell these products primarily to leading storage equipment manufacturers such as Brocade, EMC, Emulex, Hewlett-Packard Company, IBM and Qlogic.

Finisar Corporation was incorporated in California in April 1987 and reincorporated in Delaware in November 1999. Finisar's principal executive offices are located at 1389 Moffett Park Drive, Sunnyvale, California 94089, and its telephone number at that location is (408) 548-1000.

2. Summary of Significant Accounting Policies

Interim Financial Information and Basis of Presentation

The accompanying unaudited condensed consolidated financial statements as of July 29, 2007 and July 30, 2006, and for the three month periods ended July 29, 2007 and July 30, 2006, have been prepared in accordance with U.S generally accepted accounting principles for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission, and include the accounts of Finisar Corporation and its wholly-owned subsidiaries (collectively, "Finisar" or the "Company"). Inter-company accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company's financial position at July 29, 2007 and July 30, 2006 and its operating results and cash flows for the three month periods ended July 29, 2007 and July 30, 2006. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements and notes for the fiscal year ended April 30, 2007.

Fiscal Periods

The Company maintains its financial records on the basis of a fiscal year ending on April 30, with fiscal quarters ending on the Sunday closest to the end of the period (thirteen-week periods).

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Stock-Based Compensation Expense

The Company accounts for stock-based compensation in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, ("SFAS 123R") which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and directors including employee stock options and employee stock purchases

under the Company's Employee Stock Purchase Plan based on estimated fair values. SFAS 123R requires companies to estimate the fair value of stock-based payment awards on the date of grant using an option pricing model. The Company uses the Black-Scholes option pricing model to determine the fair value of stock based awards under SFAS 123R. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's consolidated statement of operations.

Stock-based compensation expense recognized in the Company's condensed consolidated statement of operations for the three months ended July 29, 2007 and July 30, 2006 included compensation expense for stock-based payment awards granted prior to, but not yet vested as of the adoption of SFAS 123R, based on the grant date fair value estimated in accordance with the provisions of SFAS 123 and compensation expense for the stock-based payment awards granted subsequent to April 30, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. Compensation expense for expected-to-vest stock-based awards that were granted on or prior to April 30, 2006 was valued under the multiple-option approach and will continue to be amortized using the accelerated attribution method. Subsequent to April 30, 2006, compensation expense for expected-to-vest stock-based awards is valued under the single-option approach and amortized on a straight-line basis, net of estimated forfeitures.

Revenue Recognition

The Company's revenue transactions consist predominately of sales of products to customers. The Company follows the Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104 *Revenue Recognition* and Emerging Issues Task Force ("EITF") Issue 00-21 *Revenue Arrangements with Multiple Deliverables* . Specifically, the Company recognizes revenue when persuasive evidence of an arrangement exists, title and risk of loss have passed to the customer, generally upon shipment, the price is fixed or determinable, and collectability is reasonably assured. For those arrangements with multiple elements, or in related arrangements with the same customer, the arrangement is divided into separate units of accounting if certain criteria are met, including whether the delivered item has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. The consideration received is allocated among the separate units of accounting based on their respective fair values, and the applicable revenue recognition criteria are applied to each of the separate units. In cases where there is objective and reliable evidence of the fair value of the undelivered item in an arrangement but no such evidence for the delivered item, the residual method is used to allocate the arrangement consideration. For units of accounting which include more than one deliverable, the Company generally recognizes all revenue and cost of revenue for the unit of accounting during the period in which the last undelivered item is delivered.

At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with sales, recorded as a component of cost of revenues. The Company's customers and distributors generally do not have return rights. However, the Company has established an allowance for estimated customer returns, based on historical experience, which is netted against revenue.

Sales to certain distributors are made under agreements providing distributor price adjustments and rights of return under certain circumstances. Revenue and costs relating to distributor sales are deferred until products are sold by the distributors to end customers. Revenue recognition depends on notification from the distributor that product has been sold to the end customer. Also reported by the distributor are product resale price, quantity and end customer shipment information, as well as inventory on hand. Deferred revenue on shipments to distributors reflects the effects of distributor price adjustments and, the amount of gross margin expected to be realized when distributors sell-through products purchased from the Company. Accounts receivable from distributors are recognized and inventory is relieved when title to inventories transfers, typically upon shipment from the Company at which point the Company has a legally enforceable right to collection under normal payment terms.

Segment Reporting

Statement of Financial Accounting Standards (SFAS) No. 131 *Disclosures about Segments of an Enterprise and Related Information* establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. SFAS 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. The Company has determined that it operates in two segments consisting of optical subsystems and components and network test and monitoring systems.

Concentrations of Credit Risk

Financial instruments which potentially subject Finisar to concentrations of credit risk include cash, cash equivalents, available-for-sale and restricted investments and accounts receivable. Finisar places its cash, cash equivalents, available-for-sale and restricted

investments with high-credit quality financial institutions. Such investments are generally in excess of FDIC insurance limits. Concentrations of credit risk, with respect to accounts receivable, exist to the extent of amounts presented in the financial statements. Generally, Finisar does not require collateral or other security to support customer receivables. Finisar performs periodic credit evaluations of its customers and maintains an allowance for potential credit losses based on historical experience and other information available to management. Losses to date have not been material. The Company's five largest customers represented 43.5% and 33.3% of total accounts receivable at July 29, 2007 and April 30, 2007, respectively.

Current Vulnerabilities Due to Certain Concentrations

Finisar sells products primarily to customers located in North America. During the three months ended July 29, 2007 and July 30, 2006, sales to the top five optical subsystems and components customers represented 45.2% and 43.8% of total revenues, respectively. One customer represented more than 10% of total revenues during each of these periods.

Included in the Company's condensed consolidated balance sheet at July 29, 2007, are the net assets of the Company's manufacturing operations, substantially all of which are located in Malaysia and which total approximately $60.6 million.

Foreign Currency Translation

The functional currency of the Company's foreign subsidiaries is the local currency. Assets and liabilities denominated in foreign currencies are translated using the exchange rate on the balance sheet dates. Revenues and expenses are translated using average exchange rates prevailing during the year. Any translation adjustments resulting from this process are shown separately as a component of accumulated other comprehensive income. Foreign currency transaction gains and losses are included in the determination of net loss.

Research and Development

Research and development expenditures are charged to operations as incurred.

Advertising Costs

Advertising costs are expensed as incurred. Advertising is used infrequently in marketing the Company's products. Advertising costs were $13,000 and $8,500 in the three months ended July 29, 2007 and July 30, 2006, respectively.

Shipping and Handling Costs

The Company records costs related to shipping and handling in cost of sales for all periods presented.

Cash and Cash Equivalents

Finisar's cash equivalents consist of money market funds and highly liquid short-term investments with qualified financial institutions. Finisar considers all highly liquid investments with an original maturity from the date of purchase of three months or less to be cash equivalents.

Investments

Available-for-Sale

Available-for-sale investments consist of interest bearing securities with maturities of greater than three months from the date of purchase and equity securities. Pursuant to SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities* , the Company has classified its investments as available-for-sale. Available-for-sale securities are stated at market value, which approximates fair value, and unrealized holding gains and losses, net of the related tax effect, are excluded from earnings and are reported as a separate component of accumulated other comprehensive income until realized. A decline in the market value of the security below cost that is deemed other than temporary is charged to earnings, resulting in the establishment of a new cost basis for the security.

Restricted Investments

Restricted investments consist of interest bearing securities with maturities of greater than three months from the date of purchase and investments held in escrow under the terms of the Company's convertible subordinated notes. In accordance with SFAS 115, the Company has classified its restricted investments as held-to-maturity. Held-to-maturity securities are stated at amortized cost.

Other

The Company uses the cost method of accounting for investments in companies that do not have a readily determinable fair value in which it holds an interest of less than 20% and over which it does not have the ability to exercise significant influence. For entities in which the Company holds an interest of greater than 20% or in which the Company does have the ability to exercise significant influence, the Company uses the equity method. In determining if and when a decline in the market value of these investments below their carrying value is other-than-temporary, the Company evaluates the market conditions, offering prices, trends of earnings and cash flows, price multiples, prospects for liquidity and other key measures of performance. The Company's policy is to recognize an impairment in the value of its minority equity investments when clear evidence of an impairment exists, such as (a) the completion of a new equity financing that may indicate a new value for the investment, (b) the failure to complete a new equity financing arrangement after seeking to raise additional funds or (c) the commencement of proceedings under which the assets of the business may be placed in receivership or liquidated to satisfy the claims of debt and equity stakeholders. The Company's minority investments in private companies are generally made in exchange for preferred stock with a liquidation preference that is intended to help protect the underlying value of its investment.

Fair Value of Financial Instruments

The carrying amounts of certain of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, accrued compensation and other accrued liabilities, approximate fair value because of their short maturities. As of July 29, 2007 and April 30, 2007, the fair value of the Company's convertible subordinated debt was approximately $276.7 million and $285.2 million, respectively.

Inventories

Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market.

The Company permanently writes down the cost of inventory that the Company specifically identifies and considers obsolete or excessive to fulfill future sales estimates. The Company defines obsolete inventory as inventory that will no longer be used in the manufacturing process. Excess inventory is generally defined as inventory in excess of projected usage and is determined using management's best estimate of future demand, based upon information then available to the Company. The Company also considers: (1) parts and subassemblies that can be used in alternative finished products, (2) parts and subassemblies that are likely to be engineered out of the Company's products, and (3) known design changes which would reduce the Company's ability to use the inventory as planned.

Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Property and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, generally three years to seven years except for buildings, which are depreciated over 40 years. Land is carried at acquisition cost and not depreciated. Leased land costs are depreciated over the life of the lease.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets result from acquisitions accounted for under the purchase method. Amortization of intangibles has been provided on a straight-line basis over periods ranging from one to nine years. The amortization of goodwill ceased with the adoption of SFAS No. 142 beginning in the first quarter of fiscal 2003.

Accounting for the Impairment of Long-Lived Assets

The Company periodically evaluates whether changes have occurred to long-lived assets that would require revision of the remaining estimated useful life of the assets or render them not recoverable. If such circumstances arise, the Company uses an estimate of the undiscounted value of expected future operating cash flows to determine whether the long-lived assets are impaired. If the aggregate undiscounted cash flows are less than the carrying amount of the assets, the resulting impairment charge to be recorded is calculated based on the excess of the carrying value of the assets over the fair value of such assets, with the fair value determined based on an estimate of discounted future cash flows.

Computation of Net Loss Per Share

Basic and diluted net loss per share is presented in accordance with SFAS No. 128 *Earnings Per Share* for all periods presented. Basic net loss per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share has been computed using the weighted-average number of shares of common stock and dilutive potential common shares from options and warrants (under the treasury stock method) and convertible notes (on an as-if-converted basis) outstanding during the period.

The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months Ended	
	July 29, 2007	July 30, 2006
	(in thousands, except per share amounts)	
Numerator:		
Net income (loss)	$ (7,321)	$ 507
Denominator for basic net income (loss) per share:		
Weighted-average shares outstanding — total	308,634	306,499
Weighted-average shares outstanding — basic	308,634	306,499
Effect of dilutive securities:		
Weighted-average shares outstanding — subject to repurchase	—	4
Weighted-average shares outstanding — employee stock options	—	17,026
Weighted-average shares outstanding — outstanding warrants	—	316
Weighted-average shares outstanding — diluted	308,634	323,845
Basic net income (loss) per share	$ (0.02)	$ 0.00
Diluted net income (loss) per share	$ (0.02)	$ 0.00
Common stock equivalents related to potentially dilutive securities excluded from computation above because they are anti-dilutive:		
Employee stock options	17,017	—
Conversion of convertible subordinated notes	35,117	58,647
Conversion of convertible notes	4,661	—
Warrants assumed in acquisition	465	40
Potentially dilutive securities	57,260	58,687

Comprehensive Income

SFAS No. 130 *Reporting Comprehensive Income* establishes rules for reporting and display of comprehensive income and its components. SFAS No. 130 requires unrealized gains or losses on the Company's available-for-sale securities and foreign currency translation adjustments to be included in comprehensive income.

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The components of comprehensive loss for the three months ended were as follows (in thousands):

	Three Months Ended	
	July 29, 2007	July 30, 2006
Net income (loss)	$ (7,321)	$ 507
Foreign currency translation adjustment	18	(585)
Change in unrealized gain (loss) on securities, net of reclassification adjustments for realized loss	(328)	11,985
Comprehensive income (loss)	$ (7,631)	$ 11,907

The components of accumulated other comprehensive income (loss), net of taxes, were as follows (in thousands):

	July 29, 2007	April 30, 2007
Net unrealized gains on available-for-sale securities	$ 4,741	$ 5,069
Cumulative translation adjustment	6,111	6,093
Accumulated other comprehensive income	$ 10,852	$ 11,162

Income Taxes

We adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – An interpretation of FASB Statement No. 109,* ("FIN 48") on May 1, 2007. FIN 48 is an interpretation of FASB Statement 109, *Accounting for Income Taxes,* and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position that an entity takes or expects to take in a tax return. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. Under FIN 48, an entity may only recognize or continue to recognize tax positions that meet a "more likely than not" threshold. In accordance with our accounting policy, we recognize accrued interest and penalties related to unrecognized tax benefits as a component of tax expense. This policy did not change as a result of our adoption on FIN 48.

3. Inventories

Inventories consist of the following (in thousands):

	July 29, 2007	April 30, 2007
Raw materials	$ 20,115	$ 21,597
Work-in-process	28,292	27,336
Finished goods	28,944	28,737
Total inventory	$ 77,351	$ 77,670

During the three months ended July 29, 2007 and July 30 2006, the Company recorded charges of $3.8 million and $3.4 million, respectively, for excess and obsolete inventory, and sold inventory that was written-off in previous periods with an approximate cost of $1.7 million and $1.1 million, respectively. As a result, cost of revenue associated with the sale of this inventory was zero.

5. Property and Equipment

Property and equipment consist of the following (in thousands):

	July 29, 2007	April 30, 2007
Land	$ 9,747	$ 9,747
Buildings	11,365	11,365
Computer equipment	38,148	37,475
Office equipment, furniture and fixtures	3,241	3,196
Machinery and equipment	140,028	135,238
Leasehold improvements	13,207	12,795
Contruction-in-process	572	444
Total	216,308	210,260
Accumulated depreciation and amortization	(131,983)	(126,189)
Property, equipment and improvements (net)	$ 84,325	$ 84,071

6. Income Taxes

The Company recorded a provision for income taxes of $621,000 and $631,000, respectively, for the three months ended July 29, 2007 and 2006. The provision for income tax expense for the three months ended July 29, 2007 and 2006 includes non-cash charges of $544,000 for deferred tax liabilities that were recorded for tax amortization of goodwill for which no financial statement amortization has occurred under generally accepted accounting principles, as promulgated by SFAS 142.

The Company records a valuation allowance against its deferred tax assets for each period in which management concludes that it is more likely than not that the deferred tax assets will not be realized. Realization of the Company's net deferred tax assets is dependent upon future taxable income the amount and timing of which are uncertain. Accordingly, the Company's net deferred tax assets as of July 29, 2007 have been fully offset by a valuation allowance.

A portion of the valuation allowance for deferred tax assets at July 29, 2007 relates to tax net operating loss carry forwards and other tax attributes of acquired companies the tax benefit of which, when realized, will first reduce goodwill, then other non-current intangible assets arising from the acquired companies, and thereafter, income tax expense.

Effective May 1, 2007, we adopted FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109." FIN 48 prescribes a recognition threshold that a tax position is required to meet before being recognized in the financial statements and provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition rules.

The adoption of FIN 48 did not result in an adjustment to beginning retained earnings and did not have any impact on our results of operations. As of the date of adoption, the Company had $9.6 million of unrecognized tax benefits. Excluding the effects of recorded valuation allowances for deferred tax assets, $7.2 million of the unrecognized tax benefits would favorably impact the effective tax rate in future periods if recognized and $1.5 million of unrecognized tax benefits would reduce goodwill if recognized.

As of date of adoption the Company has not recorded any income tax liabilities for unrecognized tax positions as no cash payments are anticipated. There have been no significant changes during the quarter ended July 29, 2007.

The Company records interest and penalties related to unrecognized tax benefits in income tax expense. As of date of adoption there were no accrued interest or penalties related to uncertain tax positions.

As a result of our global operations, the Company or its subsidiaries file income tax returns in various jurisdictions including U.S. federal, U.S. state, and certain foreign jurisdictions. The Company's U.S. federal and state income tax returns are generally not subject to examination by the tax authorities for tax years before 2003. For all federal and state net operating loss and credit carryovers, the statute of limitations does not begin until the carryover items are utilized. The taxing authorities can examine the validity of the carryover items and if necessary, adjustments may be made to the carryover items. The Company's Malaysia, Singapore, and China income tax returns are generally not subject to examination by the tax authorities for tax years before 2003, 2001, and 2003, respectively. For state purposes, we are currently under examination, however, we do not expect any significant change to our unrecognized state tax benefits within the next year.

There are no unrecognized tax benefits at July 29, 2007 related to tax positions, interest, and penalty for which it is reasonably possible that the statute of limitations will expire within the next twelve months.

6. Purchased Intangible Assets

The following table reflects intangible assets subject to amortization as of July 29, 2007 and April 30, 2007 (in thousands):

	July 29, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Purchased technology	$ 111,846	($95,224)	$ 16,622
Trade name	3,697	(3,216)	481
Customer relationships	6,964	(2,288)	4,676
Total	$ 122,507	($100,728)	$ 21,779

	April 30, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Purchased technology	$ 111,846	($93,495)	$ 18,351
Trade name	3,697	(3,171)	526
Customer relationships	6,964	(1,843)	5,121
Total	$ 122,507	($98,509)	$ 23,998

Estimated remaining amortization expense for each of the next five fiscal years ending April 30, is as follows (in thousands):

Year	Amount
2008	$ 6,030
2009	5,481
2010	3,811
2011	3,336
2012 and beyond	3,121
	$ 21,779

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7. Investments

Available-for-Sale Securities

The following is a summary of the Company's available-for-sale investments as of July 29, 2007 and April 30, 2007 (in thousands):

Investment Type	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Market Value
As of July 29, 2007				
Debt:				
Corporate	$ 63,941	$ 7	$ (63)	$ 63,885
Government agency	12,203	19	(10)	12,212
Mortgage-backed	3,402	—	(20)	3,382
Municipal	300	—	(2)	298
	$ 79,846	$ 26	$ (95)	$ 79,777
Equity:				
Corporate	$ 3,400	$ 4,811	$ —	$ 8,211
Total investments	$ 83,246	$ 4,837	$ (95)	$ 87,988
Reported as:				
Cash equivalents	$ 10,793	$ —	$ —	$ 10,793
Short-term investments	59,960	6	(56)	59,910
Long-term investments	12,493	4,831	(39)	17,285
Total	$ 83,246	$ 4,837	$ (95)	$ 87,988
As of April 30, 2007				
Debt:				
Corporate	$ 62,643	$ 9	$ (94)	$ 62,558
Government agency	12,200	26	(18)	12,208
Mortgage-backed	3,626	1	(21)	3,606
Municipal	300	—	(3)	297
Total	$ 78,769	$ 36	$ (136)	$ 78,669
Equity:				
Corporate	$ 3,607	$ 5,169	$ —	$ 8,776
Total investments	$ 82,376	$ 5,205	$ (136)	$ 87,445
Reported as:				
Cash equivalents	$ 11,079	$ —	$ —	$ 11,079
Short-term investments	56,603	3	(95)	56,511
Long-term investments	14,694	5,202	(41)	19,855
Total	$ 82,376	$ 5,205	$ (136)	$ 87,445

The gross realized losses for the three months ended July 29, 2007 and July 30, 2006 were immaterial. Realized gains and losses were calculated based on the specific identification method.

Restricted Securities

The Company has purchased and pledged to a collateral agent, as security for the exclusive benefit of the holders of the Company's 2 1/2% convertible subordinated notes, U.S. government securities, which will be sufficient upon receipt of scheduled principal and interest payments thereon, to provide for the payment in full of the first eight scheduled interest payments due on such outstanding convertible subordinated notes. These restricted securities are classified as held to maturity and are recorded on the Company's consolidated balance sheet at amortized cost. The following table summarizes the Company's restricted securities as of July 29, 2007 and April 30, 2007 (in thousands):

	Amortized Cost	Gross Unrealized Gain/(Loss)	Market Value
As of July 29,2007			
Government agency	$ 625	$ —	$ 625
Classified as:			
Short term — less than 1 year	625	—	625
Total	$ 625	$ —	$ 625
As of April 30, 2007			
Government agency	$ 625	$ —	$ 625
Classified as:			
Short term — less than 1 year	625	—	625
Total	$ 625	$ —	$ 625

8. Minority Investments

Minority investments is comprised of several investments in other companies accounted for under the cost method.

Cost Method Investments

Included in minority investments at July 29, 2007 and April 30, 2007 are cost method investments of $11.3 million for each period.

9. Stockholders' Equity

Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan, which includes its sub-plan, the International Employee Stock Purchase Plan (together the "Purchase Plan"), under which 16,750,000 shares of the Company's common stock have been reserved for issuance. Eligible employees may purchase a limited number of shares of common stock at a discount of 15% to the market value at certain plan-defined dates. During the three months ended July 29, 2007, the Company did not issue any shares under this plan. During the three months ended July 30, 2006, the Company issued 860,025 shares under this plan. At July 29, 2007, 11,060,097 shares were available for issuance under the Purchase Plan.

The Purchase Plan permits eligible employees to purchase Finisar common stock through payroll deductions, which may not exceed 20% of the employee's total compensation. Stock may be purchased under the plan at a price equal to 85% of the fair market value of Finisar common stock on either the first or the last day of the offering period, whichever is lower.

Employee Stock Option Plans

During fiscal 1989, Finisar adopted the 1989 Stock Option Plan (the "1989 Plan"). The 1989 Plan expired in April 1999 and no further option grants have been made under the 1989 Plan since that time. Options granted under the 1989 Plan had an exercise price of not less than 85% of the fair value of a share of common stock on the date of grant (110% of the fair value in certain instances) as determined by the board of directors. Options generally vested over five years and had a maximum term of 10 years.

Finisar's 1999 Stock Option Plan was adopted by the board of directors and approved by the stockholders in September 1999. An amendment and restatement of the 1999 Stock Option Plan, including renaming it the 2005 Stock Incentive Plan (the "2005 Plan"), was approved by the board of directors in September 2005 and by the stockholders in October 2005. A total of 21,000,000 shares of

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common stock were initially reserved for issuance under the 2005 Plan. The share reserve automatically increases on May 1 of each calendar year by a number of shares equal to 5% of the number of shares of Finisar's common stock issued and outstanding as of the immediately preceding April 30, subject to certain restrictions on the aggregate maximum number of shares that may be issued pursuant to incentive stock options. The types of stock-based awards available under the 2005 Plan includes stock options, stock appreciation rights, restricted stock units and other stock-based awards which vest upon the attainment of designated performance goals or the satisfaction of specified service requirements or, in the case of certain restricted stock units or other stock-based awards, become payable upon the expiration of a designated time period following such vesting events. To date, only stock options have been granted under the 2005 Plan. Options generally vest over five years and have a maximum term of 10 years. As of July 29, 2007, there were no shares subject to repurchase and at July 30, 2006, 3,700 shares were subject to repurchase.

A summary of activity under the Company's employee stock option plans is as follows:

	Options Available for Grant	Options Outstanding			
Options for Common Stock	**Number of Shares**	**Number of Shares**	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Term**	**Aggregate Intrinsic Value (1)**
				(In years)	($000's)
Balance at April 30, 2007	28,815,162	46,119,115	$2.58		
Increase in authorized shares	15,431,618				
Options granted	(2,387,500)	2,387,500	$3.91		
Options exercised		—	$0.00		
Options canceled	1,604,323	(1,604,323)	$2.58		
Balance at July 29, 2007	43,463,603	46,902,292	$2.65	6.74	$70,565

(1) Represents the difference between the exercise price and the value of Finisar common stock at July 27, 2007.

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company's closing stock price of $3.70 as of July 27, 2007, which would have been received by the option holders had all option holders exercised their options as of that date. The weighted-average remaining contractual life of options exercisable is 5.7 years. The total number of in-the-money options exercisable as of July 29, 2007 was 21.5 million.

Valuation and Expense Information under SFAS 123(R)

The following table summarizes stock-based compensation expense related to employee stock options and employee stock purchases under SFAS 123(R) for the three months ended July 29, 2007 and July 30, 2006 which was reflected in our operating results as follows (in thousands):

	Three Months Ended	
	July 29, 2007	**July 30, 2006**
	(Unaudited, in thousands)	
Cost of revenues	$ 722	$ 1,136
Research and development	955	1,176
Sales and marketing	451	529
General and administrative	631	607
Total	$ 2,759	$ 3,448

The total stock-based compensation capitalized as part of inventory as of July 29, 2007 was $397,000.

As of July 29, 2007, total compensation cost related to unvested stock options not yet recognized was $19.1 million which is expected to be recognized over the next 29 months on a weighted-average basis.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model and the straight-line attribution approach with the following weighted-average assumptions:

	Employee Stock Option Plans		Employee Stock Purchase Plan	
	July 29, 2007	July 30, 2006	July 29, 2007 (1)	July 30, 2006
Weighted average fair value per share	$2.86	$3.47	n/a	$0.90
Expected term (in years)	5.44	5.15	n/a	0.50
Volatility	88%	104%	n/a	67%
Risk-free interest rate	4.60%	5.07%	n/a	4.40%
Dividend yield	0.00%	0.00%	n/a	0.00%

(1) During the quarter ended July 29, 2007, the Company's Purchase Plan was not in effect.

Accuracy of Fair Value Estimates

The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and the stock price volatility. The assumptions listed above represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, our recorded and pro forma stock-based compensation expense could have been materially different from that depicted above. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be materially different.

10. Segments and Geographic Information

The Company designs, develops, manufactures and markets optical subsystems, components and test and monitoring systems for high-speed data communications. The Company views its business as having two principal operating segments, consisting of optical subsystems and components and network test and monitoring systems.

Optical subsystems consist primarily of transceivers sold to manufacturers of storage and networking equipment for storage area networks (SANs) and local area networks (LANs) and metropolitan access network (MAN) applications. Optical subsystems also include multiplexers, de-multiplexers and optical add/drop modules for use in MAN applications. Optical components consist primarily of packaged lasers and photo-detectors which are incorporated in transceivers, primarily for LAN and SAN applications. Network test and monitoring systems include products designed to test the reliability and performance of equipment for a variety of protocols including Fibre Channel, Gigabit Ethernet, 10 Gigabit Ethernet, iSCSI, SAS and SATA. These test and monitoring systems are sold to both manufacturers and end-users of the equipment.

Both of the Company's operating segments and its corporate sales function report to the President and Chief Executive Officer. Where appropriate, the Company charges specific costs to these segments where they can be identified and allocates certain manufacturing costs, research and development, sales and marketing and general and administrative costs to these operating segments, primarily on the basis of manpower levels or a percentage of sales. The Company does not allocate income taxes, non-operating income, acquisition related costs, stock compensation, interest income and interest expense to its operating segments. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. There are no intersegment sales.

Information about reportable segment revenues and income/(losses) are as follows (in thousands):

	Three Months Ended	
	July 29, 2007	July 30, 2006
Revenues:		
Optical subsystems and components	$ 96,360	$ 96,043
Network test and monitoring systems	9,375	10,200
Total revenues	$105,735	$106,243
Depreciation and amortization expense:		
Optical subsystems and components	$ 6,538	$ 6,424
Network test and monitoring systems	277	284
Total depreciation and amortization expense	$ 6,815	$ 6,708
Operating income (loss):		
Optical subsystems and components	$ (441)	4,970
Network test and monitoring systems	(1,076)	(191)
Total operating income (loss)	(1,517)	4,779
Unallocated amounts:		
Amortization of acquired developed technology	(1,729)	(1,519)
Amortization of purchased intangibles	(490)	(299)
Interest income (expense), net	(2,831)	(2,666)
Other non-operating income (expense), net	(133)	(370)
Total unallocated amounts	(5,183)	(4,854)
Loss before income taxes and cumulative effect	$ (6,700)	$ (75)

The following is a summary of total assets by segment (in thousands):

	July 29, 2007	April 30, 2007
Optical subsystems and components	$385,531	$392,260
Network test and monitoring systems	82,108	76,885
Other assets	73,267	77,527
	$540,906	$546,672

Short-term, restricted and minority investments are the primary components of other assets in the above table.

The following is a summary of operations within geographic areas based on the location of the entity purchasing the Company's products (in thousands):

	Three Months Ended	
	July 29, 2007	July 30, 2007
Revenues from sales to unaffiliated customers:		
United States	$ 34,176	$ 40,425
Rest of the world	71,559	65,818
	$ 105,735	$ 106,243

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Revenues generated in the United States are all from sales to customers located in the United States.

The following is a summary of long-lived assets within geographic areas based on the location of the assets (in thousands):

	July 29, 2007	April 30, 2007
Long-lived assets		
United States	$234,943	$237,691
Malaysia	27,884	26,589
Rest of the world	3,308	3,351
	$266,135	$267,631

The following is a summary of capital expenditures by reportable segment (in thousands):

	Three Months Ended July 29, 2007	Three Months Ended July 30, 2007
Optical subsystems and components	$ 5,900	$ 6,058
Network test and monitoring systems	110	59
Total capital expenditures	$ 6,010	$ 6,117

11. Warranty

The Company generally offers a one-year limited warranty for all of its products. The specific terms and conditions of these warranties vary depending upon the product sold and the end customer. The Company estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs based on revenue recognized. Factors that affect the Company's warranty liability include the number of units sold, historical and anticipated rates of warranty claims and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

Changes in the Company's warranty liability during the following period were as follows (in thousands):

	Three Months Ended July 29, 2007
Beginning balance at April 30, 2007	$ 1,818
Additions during the period based upon product sold	484
Settlements	388
Changes in liability for pre-existing warranties, including expirations	(853)
Ending balance at July 29, 2007	$ 1,837

12. Sales of Accounts Receivable

The Company has an agreement with Silicon Valley Bank to sell certain trade receivables. In these non-recourse sales, the Company removes the sold receivables from its books and records no liability related to the sale, as the Company has assessed that the sales should be accounted for as "true sales" in accordance with SFAS No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. During the three months ended July 29, 2007 and July 30, 2006, the Company sold approximately $5.3 million and $4.2 million, respectively, of its trade receivables to Silicon Valley Bank under the terms of this agreement.

13. Restructuring

As of July 29, 2007, $845,000 of committed facility payments remain accrued and are expected to be fully utilized by the end of fiscal 2011. This amount relates to restructuring activities associated with the Company's Sunnyvale and Scotts Valley facilities that took place in fiscal 2006.

14. Pending Litigation

Matters Related to Historical Stock Option Grant Practices

On November 30, 2006, the Company announced that it had undertaken a voluntary review of its historical stock option grant practices subsequent to its initial public offering in November 1999. The review was initiated by senior management, and preliminary results of the review were discussed with the Audit Committee of the Company's Board of Directors. Based on the preliminary results of the review, senior management concluded, and the Audit Committee agreed, that it was likely that the measurement dates for certain stock option grants differed from the recorded grant dates for such awards and that the Company would likely need to restate its historical financial statements to record non-cash charges for compensation expense relating to some past stock option grants. The Audit Committee thereafter conducted a further investigation and engaged independent legal counsel and financial advisors to assist in that investigation. The Audit Committee concluded that measurement dates for certain option grants differ from the recorded grant dates for such awards. The Company's management, in conjunction with the Audit Committee, conducted a further review to finalize revised measurement dates and determine the appropriate accounting adjustments to its historical financial statements, which are reflected in this report. The announcement of the investigation, and related delays in filing this quarterly report on Form 10-Q for the quarter ended July 29, 2007, the Company's quarterly reports on Form 10-Q for the quarters ended October 29, 2006 and January 28, 2007, and its annual report on Form 10-K for the fiscal year ended April 30, 2007, have resulted in the initiation of regulatory proceedings as well as civil litigation and claims. Financial information included in the Company's reports on Form 10-K, Form 10-Q and Form 8-K filed by Finisar prior to November 28, 2006 and the related reports of its independent registered public accounting firm, included in the Forms 10-K, and all earnings and press releases and similar communications issued by the Company prior to November 28, 2006 should not be relied upon and are superseded in their entirety by the annual report of Form 10-K for the fiscal year ended April 30, 2007, the other reports on Form 10-Q, including this report, and Form 8-K filed by the Company with the Securities and Exchange Commission on or after November 28, 2006.

Nasdaq Determination of Non-compliance

On December 13, 2006, the Company received a Staff Determination notice from the Nasdaq Stock Market stating that the Company was not in compliance with Marketplace Rule 4310(c)(14) because it did not timely file the October 10-Q and, therefore, that its common stock was subject to delisting from the Nasdaq Global Select Market. The Company received similar Staff Determination Notices with respect to its failure to timely file the January 10-Q, the July 10-Q and the 2007 10-K. In response to the original Staff Determination Notice, the Company requested a hearing before a Nasdaq Listing Qualifications Panel (the "Panel") to review the Staff Determination and to request additional time to comply with the filing requirements pending completion of the Audit Committee's investigation. The hearing was held on February 15, 2007. The Company thereafter supplemented its previous submission to Nasdaq to include the subsequent periodic reports in its request for additional time to make required filings. On April 4, 2007, the Panel granted the Company additional time to comply with the filing requirements until June 11, 2007 for the October 10-Q and until July 3, 2007 for the January 10-Q. The Company appealed the Panel's decision to the Nasdaq Listing and Hearing Review Counsel (the "Listing Council"), seeking additional time to make the filings. On May 18, 2007, the Listing Council agreed to review the Panel's April 4, 2007 decision and stayed that decision pending review of the Company's appeal. On October 5, 2007, the Listing Council granted the Company an exception until December 4, 2007 to file its delinquent periodic reports and restatement. On November 26, 2007, the Company filed an appeal with the Nasdaq Board of Directors seeking a review of the Listing Council's decision and a stay of the decision, including the Listing Council's December 4, 2007 deadline. On November 30, 2007, the Nasdaq Board of Directors agreed to review the Listing Council's decision and stayed the decision pending further consideration by the Board. The Company believes that the filing of this report, and the simultaneous filing of its other delinquent reports on Form 10-Q and Form 10-K, will satisfy the conditions of the Listing Council's decision and that its common stock will continue to be listed on the Nasdaq Global Select Market.

Securities and Exchange Commission Inquiry

In November 2006, the Company informed the staff of the Securities and Exchange Commission (the "SEC") of the voluntary investigation that had been undertaken by the Audit Committee of the Board of Directors. The Company was subsequently notified by the SEC that the SEC was conducting an informal inquiry regarding the Company's historical stock option grant practices. The Company is cooperating with the SEC's review.

Stock Option Derivative Litigation

Following the announcement by the Company on November 30, 2006 that the Audit Committee of the Board of Directors had voluntarily commenced an investigation of the Company's historical stock option grant practices, the Company was named as a nominal defendant in several shareholder derivative cases. These cases have been consolidated into two proceedings pending in federal and state courts in California. The federal court cases have been consolidated in the United States District Court for the Northern District of California. The state court cases have been consolidated in the Superior Court for the State of California for the County of Santa Clara. Plaintiffs in all cases have alleged that certain current or former officers and directors of the Company caused it to grant stock options at less than fair market value, contrary to the Company's public statements (including its financial statements), and that, as a result, those officers and directors are liable to the Company. No specific amount of damages has been alleged, and by

the nature of the lawsuits no damages will be alleged, against the Company. On May 22, 2007, the state court granted the Company's motion to stay the state court action pending resolution of the consolidated federal court action. On June 12, 2007, the plaintiffs in the federal court case filed an amended complaint to reflect the results of the stock option investigation announced by the Audit Committee in June 2007. On August 28, 2007, the Company and the individual defendants filed motions to dismiss the complaint. A hearing on the motions has been set for January 11, 2008.

Trust Indenture Litigation

On January 4, 2007, the Company received three substantially identical purported notices of default from U.S. Bank Trust National Association, as trustee (the "Trustee") for the Company's 2 1/2% Convertible Senior Subordinated Notes due 2010, its 2 1/2% Convertible Subordinated Notes due 2010 and its 5 1/4% Convertible Subordinated Notes due 2008 (collectively, the "Notes"). The notices asserted that the Company's failure to timely file the October 10-Q with the SEC and to provide a copy to the Trustee constituted a default under each of the three indentures between the Company and the Trustee governing the respective series of Notes (the "Indentures"). The notices each indicated that, if the Company did not cure the purported default within 60 days, an "Event of Default" would occur under the respective Indenture. As previously reported, the Company had delayed filing the October 10-Q pending the completion of the review of its historical stock option grant practices conducted by the Audit Committee of its Board of Directors.

The Company believes that it is not in default under the terms of the Indentures. The Company contends that the plain language of each Indenture requires only that the Company file with the Trustee reports that have actually been filed with the SEC, and that, since the October 10-Q had not yet been filed with the SEC, the Company was under no obligation to file it with the Trustee.

In anticipation of the expiration of the 60-day cure period under the notices on March 5, 2007, and the potential assertion by the Trustee or the noteholders that an "Event of Default" had occurred and a potential attempt to accelerate payment on one or more series of the Notes, on March 2, 2007, the Company filed a lawsuit in the Superior Court for the State of California for the County of Santa Clara against U.S. Bank Trust National Association, solely in its capacity as Trustee under the Indentures, seeking a judicial declaration that the Company is not in default under the three Indentures, based on the Company's position as described above. The Trustee filed an answer to the complaint generally denying all allegations and also filed a notice of removal of the state case to the United States District Court for the Northern District of California. On October 12, 2007, the action was remanded back to the state court in which it was commenced because the Trustee's notice of removal was not timely.

As expected, on March 16, 2007, the Company received three additional notices from the Trustee asserting that "Events of Default" under the Indentures had occurred and were continuing based on the Company's failure to cure the alleged default within the 60-day cure period.

On April 24, 2007, the Company received three substantially identical purported notices of default from the Trustee for each of the Indentures, asserting that the Company's failure to timely file the January 10-Q with the SEC and to provide a copy to the Trustee constituted a default under each of the Indentures. The notices each indicated that, if the Company did not cure the purported default within 60 days, an "Event of Default" would occur under the respective Indenture. The Company believes that it is not in default under the terms of the Indentures for the reasons described above.

On June 21, 2007, the Company filed a second declaratory relief action against the Trustee in the Superior Court of California for the County of Santa Clara. The second action is essentially identical to the first action filed on March 2, 2007 except that it covers the notices asserting "Events of Default" received in April 2007 and any other notices of default that the Trustee may deliver in the future with respect to the Company's delay in filing, and providing copies to the Trustee, of periodic reports with the SEC. The Trustee filed an answer to the complaint generally denying all allegations and filed a notice of removal to the United States District Court for the Northern District of California. The Company has filed a motion to remand to state court, which was heard and taken under submission on November 2, 2007.

On July 9, 2007, the Company received three substantially identical purported notices of default from the Trustee for each of the Indentures, asserting that the Company's failure to timely file this Form 10-K report with the SEC and to provide a copy to the Trustee constituted a default under each of the Indentures. As before, the notices each indicated that, if the Company did not cure the purported default within 60 days, an "Event of Default" would occur under the respective Indenture. The Company believes that it is not in default under the terms of the Indentures for the reasons described above.

To date, neither the Trustee nor the holders of at least 25% in aggregate principal amount of one or more series of the Notes have declared all unpaid principal, and any accrued interest, on the Notes to be due and payable, although the Trustee stated in the notices that it reserved the right to exercise all available remedies. As of October 31, 2007, there was $250.3 million in aggregate principal amount of Notes outstanding and an aggregate of approximately $558,000 in accrued interest.